Towards a Single European Defense Market
The Contribution of EU Initiatives
Updated May 2002

SUMMARY

1. European Union (**EU**) level initiatives are complementing industry led efforts to create a more integrated EU defense market. In particular the development of a Common European Security and Defense Policy (**CESDP**) has the potential to push EU national markets together and reduce fragmentation. Under the right conditions this could lead in the medium term to a more coherent, larger scale market for US contractors to sell into. This short report tracks the development of the CESDP as well as European Commission efforts to promote a competitive European defense industry by encouraging a single market for defense products and services. It sets out developments in both areas, makes a first assessment of their likely impact on the EU's defense market, and briefly outlines likely next steps. This report should be read in conjunction with the national defense market research produced by the Show Case Europe Network.

2. The focus here is on initiatives taken together by the 15 Member States (**MS**) or by the European Commission. These need to be distinguished from bilateral or multilateral cooperation between Member States, such as the OCCAR[1] initiative, and from cooperation within the Western European Union (WEU). The EU has a smaller role to play in the regulation of the defense industry than it does in other sectors, such as telecoms, because MS are unwilling to pool sovereignty in such a strategically important and politically sensitive area. Nevertheless, circumstances are changing this attitude and recent years have seen the development of the CESDP as part of the EU's broader Common Foreign and Security Policy[2] (CFSP). Neither the CESDP nor the CFSP should be confused with the NATO inspired European Security and Defense Identity (ESDI). This originated in the decisions taken by NATO in Berlin (1996) aimed at giving the European members of NATO the possibility of using the resources and capabilities of the Atlantic Alliance for crisis management.

COMMON EUROPEAN SECURITY AND DEFENSE POLICY

3. The EU's recent commitment to setting up a Rapid Reaction Force and the establishment of new permanent military bodies within its institutions are the clearest signs yet that a European defense identity is in the making. The concept of an EU role in defense is not new but the idea was given fresh impetus by the outbreak of war in Yugoslavia. The Kosovo crisis, in particular, showed how ill equipped the EU was to

[1] Joint Organization for Armaments Cooperation set up by France, Germany, the UK and Italy
[2] http://ue.eu.int/pesc/default.asp?lang=en Common Foreign and Security Policy

deal with security risks in its immediate geographic vicinity. Through the Maastricht Treaty (1992) EU countries agreed to develop a CFSP, including a common defense policy. Summit meetings of EU leaders over the last couple of years have served to clarify the roles and goals first outlined at Maastricht and then developed through the Amsterdam Treaty (1997).

RAPID REACTION FORCE

4. At the 1999 Helsinki European Council[3] the EU member countries set themselves the goal of putting together a force capable of carrying out humanitarian, peace-keeping and crisis management operations (the Petersburg Tasks) at short notice and for long periods. Specifically, the "Headline Goal" challenges the EU to be able to send out a 60,000 strong force within 60 days and sustainable for up to a year – all this by 2003. This is not the creation of an EU army and the EU is not assuming territorial defense responsibilities. What it is doing is to direct part of MS' defense efforts to the material needs of conflict prevention and crisis management tasks.

5. EU countries began the process of identifying what resources the EU had and what extra it needed to fulfil its CESDP aspirations during the November 2000 Capabilities Commitment Conference[4]. They confirmed gaps in "strategic" capabilities such as command, control, communications and transport, and recognized that more specific efforts would be necessary to improve operational capabilities in the framework of a crisis-management operation. This includes resources for search and rescue in operational conditions, defense against ground-to-ground missiles, precision weapons, logistic support, and simulation tools. At the follow up Capability Improvement Conference one-year later the Member States reiterated their determination to fill capability gaps and agreed on a "European Capability Action Plan". The scheme focuses on mobilizing all investments, developments and coordination measures, both nationally and regionally to match existing and future resources with capability requirements.

6. So does all this mean that Europe is taking its defense capability seriously – will spending on defense rise? Much will depend on the extent to which EU finance ministers share their defense counterparts' declared enthusiasm for filling capability gaps. For the countries concerned, these efforts and those deployed as part of NATO's Defense Capabilities Initiative (DCI) will be mutually reinforcing. A US Department of Defense report in December 2000 considered that "the jury is still out on Europe's willingness to follow through on all agreed DCI objectives". The same could be said for its Rapid Reaction Force and its CESDP collective capabilities.

---

[3] http://ue.eu.int/pesc/default.asp?lang=en – Helsinki European Council (in Military Structures Section)
[4] http://ue.eu.int/pesc/default.asp?lang=en – Capabilities Commitment Conference (in Military Structures section)

NEW INSTITUTIONAL ARRANGEMENTS

7. Even if the current shape of CESDP is no guarantee of a bigger EU defense market it should lead to a less fragmented one. If customers share common strategic objectives such as the Headline Goal[5] there is a bigger likelihood of more harmonized purchasing. The recent establishment of political and military bodies[6] within the EU's institutional structure is likely to reinforce this trend. The **Political and Security Committee** (PSC) brings together national representatives at ambassadorial level and gives guidance to the **Military Committee (MC),** which is made up of Chiefs of Defense, represented by military delegates. The Military Committee advises the PSC and gives direction to the **Military Staff** who provide the military expertise on a permanent basis within the Council of Ministers Secretariat. They will provide situation assessment and strategic planning for the Petersberg tasks

8. These new institutional arrangements will bring EU defense customers together on a more regular and systematic basis, providing ongoing opportunities to develop common objectives. This trend towards strengthened cooperation in the field of armaments has been reinforced under the Spanish Presidency of the EU. An informal meeting of the EU National Armaments Directors was held in Madrid in April 2002 and EU Defense Ministers also got together[7], for the first time as an EU group in the context of the General Affairs Council, to discuss military capabilities. These meetings of minds could be a driver for more effective collaboration on procurement. Indeed the Helsinki Summit conclusions contained a commitment by MS to harmonize military requirements and the planning and procurement of arms *as MS consider appropriate.* The setting up of institutional mechanisms is also likely to provide momentum to the development of an EU defense policy. With the key players meeting regularly we are unlikely to see less EU defense policy than we have now.

DEFENSE SINGLE MARKET – DEMAND SIDE

9. The Eurofighter, Meteor and A400M projects indicate a certain commitment to European programs but are only the first step in unifying European arms procurement. OCCAR – the Joint Organization for Armaments Cooperation set up by France, Germany, the UK and Italy – is an attempt to rationalize the management of joint procurement in these collaborative programs. Its underlying objective is to ensure that national work share requirements do not impact too negatively on the cost efficiency of any one program. Essentially the production rewards per Member State are evened out over a range of programs. The system is designed to make the best of a bad situation and its impact is likely to be limited as long as each country has its own procurement office. The European Commission has tried to encourage a

[5] http://ue.eu.int/pesc/default.asp?lang=en – Headline Goal (in Military Structures Section)
[6] http://ue.eu.int/pesc/default.asp?lang=en – see EU Military Structures
[7] http://ue.eu.int/pressData/en/gena/70459.pdf

consolidation of the demand side by pushing for EU wide procurement reforms and pan-European Standards.

10. The Commission's 1997 Action Plan on "Implementing EU Strategy in the field of [8] called for action in both areas. From the Commission's perspective progress has been disappointingly slow, with national governments unwilling to play ball and keen to retain the right to procure military equipment in ways which best suit their strategic and industrial interests. However, encouraged by the new momentum for defense market reform provided by the CESDP, the Commission organized a conference on "European Defense Procurement in the 21 Century". The central theme was whether, as the Commission believes, EU wide defense production needs a more coordinated and transparent European defense standardization system. The conference's key conclusion was that work should begin on developing a European Handbook of Defense Standards with an increasing emphasis on available civil standards.. The European Commission argues that the Handbook will "improve interoperability, harmonization and cost efficiency". Standards Specialists from EU Ministries of Defense are working on the project under the auspices of main European Standards body – CEN.

DEFENSE SINGLE MARKET –SUPPLY SIDE

11. Industry has led the charge on the supply side with the formation of EADS, BAE Systems and Thales transforming the complexion of European defense industry. But over-capacity and duplication remains with the EU still supporting more helicopter and aircraft manufacturers, missile manufacturers, armored vehicle contractors and shipyards than the US and on less than half the budget. Joint Ventures (JV), such as the European Military Aviation Co (EADS and Finmeccanica) and Matra-BAE Dynamics (BAE Systems, EADS and Finmeccanica), are popular but provide less scope for cost cutting than full blown mergers and can lead to contradictory strategies and clashes of interests. However they are often the only available option because on most occasions cross border merger within the EU is just too complicated.

12. The recently approved European Company Statute[9] could make restructuring across borders easier. Companies choosing to become a Societas Europaea, or SE, will be able to register themselves under one single model and a uniform legal structure, while operating throughout the EU Member States. The national governments reached a political agreement in December 2000 but companies will have to wait until 2004 for the new statute to be fully applicable throughout the EU.

13. The Commission's work on procurement and standards initiatives represents part of its larger effort to bring its experience in organizing and regulating European markets

---

[8] http://www.europa.eu.int/comm/enterprise/defence/defence_docs/def_comm.htm. Commission Action Plan

[9] - http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/01/1376|0|RAPID&lg=EN

to bear in the defense sector. It has pursued several supply initiatives geared to removing obstacles to pan-European cooperation by freeing up the movement of armaments products into, within and out of the EU. These include efforts to simplify the licensing system for intra-community transfers, to harmonize customs duties for military and dual-use equipment, and to develop codes of conducts for dual-use exports.

14. The European Parliament has been increasingly supportive of the Commission in this area. In a recently adopted Resolution[10] it reiterated its support for the Commission's 1997 Action Plan, regretted that so little progress has been made in implementing it. It urged the Commission to develop an updated version to consider matters such as the extent to which the EU's common commercial policy and the discipline of the Single Market should be applied to the defense industries; how European research in the defense field can be better pooled and coordinated; and what further measures are needed to promote the emergence of transnational defense companies. The Commission is committed to updating the plan.

15. However all these initiatives rely on the support of MS who have so far been cautious. Indeed efforts outside the EU framework have been more promising. *The Letter of Intent* (LoI) Framework Agreement between the UK, France, Sweden, Spain, Germany and Italy sets out a number of practical, legally binding measures which will progressively remove the impediments to the effective functioning of the European defense industry. It aims to facilitate industry restructuring by making it easier for companies to work together by addressing issues such as the transfer of classified information and intellectual property rights. The principles that underpin the LoI framework might eventually be adopted more widely in the EU.

CONCLUSIONS

16. The CESDP is a market shaper but its impact has yet to be felt. According to a recent report by the London-based Institute of Strategic Studies, spending on defense and related Research and Development in the EU fell 5% in real terms during 2000. This contrast sharply with the recent one-off increase in US military expenditure which surpassed the the total annual defense expenditures of the UK and Italy combined. There is a broader political debate concerning the need for and motives behind the CESDP, but with national EU defense budgets low and falling it, at the very least, introduces a dynamic which focuses attention on capability shortfalls and sets common objectives. In this sense CESDP can be seen as a medium term to long term driving force for a more harmonized and potentially larger EU defense market.

17. Defense remains one of the few industries still largely untouched by the cross-border synergies of the Single Market. The Commission's attempts to change that have been

10 http://www3.europarl.eu.int/omk/omnsapir.so/cre?FILE=20020409r&LANGUE=EN&LEVEL=TOC2&CHAP=7 - debate leading to adoption

hamstrung by MS reluctance to breathe life into its proposals for facilitating a single EU armament's market. It is clear that commitment to CESDP has not yet translated into the national support the Commission needs to carry forward its attempts to facilitate common rules on intra-community transfers, import tariffs and exports of military products. The Commission plugs on and is as stated earlier is likely to update its 1997 Action Plan in the near future.

18. EU governments' apparent commitment to building common objectives and capabilities in the defense area provides an interesting context for changing the shape of the European defense market. The consolidation trend is irrefutable. A more harmonized market would be a more attractive proposition for US business under the right conditions. This is an important proviso. Changing procurement practices could, potentially, undermine existing market access arrangements governed by the Memorandums of Understanding the US has signed with many NATO allies. The openness to US bids of OCCAR and any future EU armaments agency will have to be carefully monitored.

19. For further information or feedback please do not hesitate to contact the Foreign Commercial Service at the United States Mission to the European Union – Brussels.ec.office.box@mail.doc.gov. For further information on the services provided by the Commercial Service to the European Union please visit http://www.buyusa.gov/europeanunion/